Community Association Management Insider®

NOVEMBER 2009

INSIDE THIS ISSUE

Despite FCC Ban, Member Must Pay for Cable

A Philadelphia municipal judge recently ruled in favor of a condo association against a member who refused to pay his cable TV bills. The member claimed that the association violated the FCC ban on exclusive cable deals. He argued that the association gets bulk billing from Comcast, forcing all owners to pay for "basic" cable, whether they want it or not. The judge ruled that there was no FCC violation—that the association's cable contract doesn't prohibit a condo owner from getting another cable provider—although he would have to pay two cable bills.

The FCC banned "exclusive" contracts in late 2007, but let stand very similar "bulk-billing" arrangements. To take advantage of bulk-billing rates, all residents must participate. They can still get a competing service—but still have to pay the cable bill.

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FEATURE

How to Handle Short-Sale Requests from Lenders, Delinquent Members

In these difficult financial times, more and more members are finding the need to sell their homes through the short-sell process as a result of declining home prices and the present state of the economy. For members who owe a lender more than what their properties are currently worth and can no longer make their mortgage payment due to a job loss, divorce, or resetting of an adjustable-rate mortgage, foreclosure seemed like the only alternative—until relatively recently.

Due to government pressure on lenders to avoid preventable foreclosures, and the fact that the lenders already have numerous foreclo-

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CONTRACTS

Negotiating Points for Laundry-Room Service Contract

Having a well-maintained laundry room in a condominium building or a community is a definite plus for members and associations. Associations benefit from ancillary income, and members don't have to find off-site laundromats, where they may have to spend hours waiting for machines.

But a laundry room can quickly turn into a management headache if machines break down, service calls are ignored, and members start complaining. As a result, engaging a service provider to handle your community's laundry facility is an important process, and the contract you negotiate should be thorough. It should outline the expectations of both parties during the time period of the contract, including maintenance, service, and payment.

The money you may earn is an important negotiating point. Most laundry-room contracts are on a concession basis. This means that the laundry-room service company installs the machines at its own expense and pays you a flat fee, a percentage of the receipts, or a flat fee plus a percentage of the "override." The association pays for the utilities. According to Steve Breitman, president of SEBCO Laundry Systems, typical leases are five to 10 years in length, and the term is mostly driven by the equipment cost and the return that the laundry company can expect from collections.

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Community Association Management Insider (ISSN 1537-1093) is published by Vendome Group, LLC, 149 Fifth Avenue, New York, NY 10010-6823.

Volume 9, Issue 5

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Short-Sale Requents (continued from p. 1)

sures on their books, lenders are realizing that they need to work with their borrowers on resolving these issues.

As a result, short sales are quickly becoming the most popular solution for many financially distressed members right now. The National Association of Realtors (NAR) reports that the number of short-sale properties on the market is rising. The NAR first measured distressed sales in March 2008, when they made up 18 percent of existing home sales. By December 2008, that number rose to 40 percent. This year, distressed sales peaked in March at 49 percent.

In a short sale, the lender agrees to accept a payoff on a home mortgage that is less than what the owner of the property actually owes on the mortgage. For example, a member who is facing foreclosure has an existing first mortgage of $300,000, yet the house is worth only $220,000. The member may decide to submit an accepted buyer's offer to the lender for $220,000. If the lender agrees to the offer, then the lender accepts the offer as full payment for the loan. This transaction is now referred to as a short sale.

But short sales raise unique questions and pose particular challenges for community associations. As in any real estate transaction, the purchaser in a short sale requires clear title to the property, which includes an assurance that association dues have been paid. Since members who fall behind on their mortgage payments usually fall behind on their assessments, association boards are often asked to waive these payments so the short sale can go through unencumbered by the delinquency. We will discuss the issues that need to be considered by the association when deciding whether to waive these payments.

Associations Have Upper Hand

From the lender's perspective, a short sale saves many of the costs associated with the foreclosure process—attorney's fees, the eviction process, delays from borrower bankruptcy, damage to the property, costs associated with resale, etc. In a short-sale scenario, the lender gets the property back faster, so it is able to cut its losses. No court approval is necessary.

Maryland attorney Michael Nagle is quick to note that he has little sympathy for lenders in this situation since they were the ones that approved the loan that the borrower could not repay in the first place. "The likelihood is that they want out from under as cheaply as possible and that it will be cheaper in many cases to pay the association instead of foreclosing. A longer foreclosure period means that the lender will be waiting during that time—and carrying the liability on its books," says Nagle. He suggests that associations not give in too easily in these circumstances.

Massachusetts attorney Douglas Errico's approach to short sales is also to be firm, at least when first approached. He points out that

Massachusetts and 16 other states have "super lien" laws. These laws guarantee the right of condominium associations to collect up to six months in delinquent common area fees from the owner or from the lender that forecloses on the mortgage.

Therefore, if the association refuses to waive delinquent common area fees in a short sale, the sale will go through anyway, in which case the association will collect the unpaid fees from the sale proceeds; or the sale will fall through and the lender will foreclose, at which point, the association will collect the amount due. The association gets paid either way.

"Even for amounts where the super lien doesn't apply—such as to assessments beyond six months, special assessments, late charges, interest, fines, etc.—we still have a lien that can only be wiped out by an actual foreclosure by the bank, and the bank might not want to go that route because of ongoing costs, delays, bad publicity, etc. So I think it's always best to call the lender's bluff, at least initially, to see what the reaction is," says Errico.

Fairness Principle

Another reason to be reluctant to agree to a waiver is on the basis of fairness. There are members in your community who are paying their share of the association's expenses, and waiving fees to allow short sales effectively penalizes paying members by requiring them to make up the difference for those who do not.

The lenders or real estate brokers requesting short-sale fee waivers will usually argue that the member is losing his home and any equity in it, while the lender is being forced to take a haircut on the mortgage. By asking for a waiver, they are also asking your association to share in the loss. But increasing loss of equity is not a valid reason to do so.

"The association never shares in the upside, and unlike the owner and the bank, its responsibilities were never voluntarily assumed," says Errico. The board was not a party to the original transaction. It didn't check the borrower's credit or approve a loan the borrower could not repay. And the board had no authority to prohibit the buyer from purchasing a home in the community.

Possible Exceptions

In some situations, it may be more beneficial to the association to discharge a fee or to negotiate further with a lender for at least a share of the debt. A short sale might benefit an association if it can be completed more quickly than a foreclosure. Getting a new owner in place will steady an association's cash flow.

Therefore, an important consideration is the length of time it takes in your jurisdiction for a foreclosure to be completed, says New Jersey attorney David Ramsey. "New Jersey is not a nonjudicial foreclosure state. In states that are, the foreclosure process might go rather quickly, but today in New Jersey, foreclosures are taking a year or more, meaning the association is going to be stuck sitting around waiting for the foreclosure to occur—and likely not getting paid in the meantime."

An association may want to consider a discharge if the debt owed to the association is not significant. According to Ramsey, an association may decide that it is not worth the effort that would be needed to resolve this with the lender, and the association should probably let it go to get in a new buyer who will pay his fees.

The fact that the lender is considering a short sale probably means there is no equity. But Ramsey advises that associations do their due diligence. Associations probably will have a good sense of what certain homes in their communities are worth. Ramsey has seen situations during this market in which there is a substantial amount of money due to the association and there is equity. In these instances, the association may be able to get paid out of excess funds at the sale, and may even want to bid at a foreclosure sale to protect its lien, particularly if it is second in line.

Insider Sources

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Contracts (continued from p. 1)

But besides money, there are many other critical factors to raise and resolve when negotiating with a laundry-room service company. You will need a specific agreement written for the particular needs of your community. The following are some important points to consider when negotiating a laundry-room service contract.

Consider Ancillary Uses to Laundry Room

Laundry rooms may be used not only for washing and drying. If you negotiate a contract with only these activities in mind, you may forgo other potentially profitable activities that you, or someone else, could perform.

When members spend time in the laundry room, they may get hungry and thirsty. Or they may get bored waiting and may want to buy a newspaper or a paperback. Of course, there are vending machines that will satisfy these members. If your service contract grants the laundry company unrestricted use of the laundry room, you may not be allowed to participate in these potentially lucrative activities.

Choose Convenient Location

The operator may push for a central location for your laundry room because it is easier to service the machines," notes John Rheinstein, a New York manager. But the association has to consider what is convenient for the members. If the community is spread out over multiple buildings such as in a townhouse garden-style arrangement, you may want to provide laundry facilities at each building, rather than in one centrally located laundry room. Or if you manage a large high-rise condominium, you may want to provide laundry facilities on every floor or in several locations in the building.

Ensure Sufficient Number of Machines

Rheinstein warns that the laundry-room service company may want to reduce its initial capital outlay by installing fewer machines. The operator may offer you a higher percentage of the gross if he puts in fewer machines. While this may give you an immediate benefit, it is not a good idea for the community in the long term. With too few machines, members will eventually get fed up with waiting for machines and take their laundry elsewhere. Also, these machines will wear down faster. This will create more of an inconvenience to you and your members due to increased service calls from malfunctioning machines.

It is important to have the correct ratio of equipment to members. This will depend on both the size of your community and its member profile. Working-class families and families with children may do five or more loads of wash each week, while young professionals send more clothing to the dry cleaner. Elderly members, who are less active, may do only one load of laundry per week.

Get Speedy Service Commitment

The biggest complaint you are likely to get from members about your laundry room is that the machines break down too often. Since breakdowns are inevitable, the length of time it takes the company to respond to your repair call is crucial.

In negotiating a laundry-room contract, a solid maintenance and service agreement is more important than the amount of revenue you will receive. According to Rheinstein, typical response times on service calls range from 24 hours to 72 hours. He recommends that you don't settle for less than a 48-hour response time.

Your contract should contain a clause defining "satisfactory" service in terms of response hours and specifying what action you should take if this time is not met. If the time is not met, give the company notification of a default of the contract by certified mail. The end result should be that you have the ability to cancel the contract if the service company does not meet the specified terms.

Negotiate Rate Control, Refunds

One thing that may seem small but is a great source of annoyance to members is losing money in the washer or dryer and having to wait three weeks to get a check for 75 cents from the operator. The operator should give the association manager the authority to make on-the-spot refunds to members on his behalf.

You will also want some control over cost increases to the members. Most laundry-room service companies will want total control over this provision, but you can ask for a mutual-consent clause. The operator will then have to get your approval before he increases prices on the machines.

Get Paid Monthly

Frequency of collection is also important. Some laundry-room service companies will not formally agree to a specified frequency of

payments and may even try to pay you rent only once a year. Rheinstein suggests they pay rent every month, since collections are made at least that frequently.

Beware of any contract provision that suspends rent payments to you if collections fall below a set dollar amount per machine per day. Since you are giving a laundry-room service company the privilege of using your space on a continuous basis, it should pay you regularly, without interruption.

Require Adequate Liability Insurance

Make sure the operator carries liability insurance over and above what is provided for in your association's insurance policy. If the laundry-room equipment malfunctions and causes a flood, you want to be sure you are fully compensated for damages that may have occurred to your building's structure.

Beware of Automatic-Renewal Trap

Most laundry-room service contracts contain automatic-renewal clauses. With these clauses, unless, before a specified deadline, you notify the operator that you do not want to renew, the contract is automatically renewed. Your notification usually must be received a certain number of days or months before the contract is set to expire.

The problem with such "negative option" arrangements is that you are likely to overlook the deadline. As a result, you are trapped into an automatic renewal. That may be for one additional term. Or, in some contracts, automatic renewal can recur indefinitely, term after term, as long as you keep forgetting to say no by each successive deadline. Obviously, if you are dissatisfied with your laundry-room service company, or just want the freedom to get competitive bids, automatic renewal is a big problem.

To complicate matters, some operators will seek not only automatic renewal, but also a right of first refusal. Thus, even if you do prevent the contract from renewing, the operator has the right to continue providing laundry service for another contract term if he can match any competitive bid you may have obtained from another company.

Check with your lawyer to see whether automatic-renewal clauses are enforceable. New York, for example, has a law that invalidates such clauses unless the company gives you proper advance notification that a deadline is coming up and warns you to exercise your rights.

If you do agree to an automatic-renewal provision, make sure it gives you ample opportunity to cancel service before the contract ends. Give yourself at least 30 to 90 days to find another laundry-room service company with which you can do business.

Insider Sources

Steve Breitman: President, Sebco Laundry Systems; 30 US Highway 22, Green Brook, NJ 08812; *www.sebcolaundry.com.*

John Rheinstein: Property Manager, Douglas Elliman Property Management; 675 3rd Ave., New York, NY 10017; *www.ellimanpm.com.*

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Search Our Web Site by Key Words: laundry room; laundry-room service contract; amenities

DOS & DON'TS

✓ *Review Terms of Insurance Policies after Purchasing Them*

Be sure to review the terms of your association's insurance policies after purchasing them. Somewhere in the purchasing process, an agent may have entered a wrong number, and your association may be getting less coverage than it expected.

This happened in a recent case in which a member suffered substantial water and mold damage to her condominium as a result of Hurricane Katrina. After the hurricane, the member notified the association and made claims under the applicable policies for damages sustained to her unit. These claims were either denied or only partially paid.

Sometime before the hurricane, the association, with the consent of its members, authorized its insurance agent to increase the limits of its policy to $2,471,000. Instead, the insurance agent mistakenly obtained a policy for only $247,100. This was the policy limit for the association's insurance policy at the time Hurricane Katrina struck the area, and it was grossly insufficient.

The member sued the association for negligently obtaining inadequate insurance. The association denied liability and claimed that the member either knew or should have known of the extent of coverage and should have taken steps to secure her own or better coverage.

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Dos & Don'ts (continued from p. 5)

The association eventually lost. Under Louisiana law, an insured has a duty to read and to know the provisions of his insurance policy. As such, the court stated that the association president had a duty to review the flood insurance policy once it was obtained. He failed to do so. Also, the court noted that the association was under no obligation to get primary insurance to cover the building and the condo units within the building. However, once the association contracted for such insurance and informed the members that the policy would have a $2.4 million limit, it was under an obligation to ensure that the association actually received what it contracted for. The court ruled that the association breached that duty by failing to review the policy after obtaining it [King v. State Farm Ins., October 2009].

✓ Share Space Heater Safety Tips with Members

The cold weather has arrived in many parts of the country, bringing with it the increased threat of fires due to the improper use of electric space heaters. According to the National Fire Protection Association, space heaters account for one-third (32 percent) of home-heating fires and three-fourths (73 percent) of home-heating fire deaths.

To help your members stay safe this winter, it's a good idea to share with them a few safety guidelines for using space heaters. Include these tips, from the U.S. Consumer Product Safety Commission, in your community newsletter, in a memo, and on common area bulletin boards:

- Make sure that the heater is placed on a level, hard, and nonflammable surface (such as ceramic tile floor), not on rugs or carpets or near bedding or drapes.
- Keep the heater at least three feet from bedding, drapes, furniture, and other flammable materials.
- Keep children and pets away from space heaters.
- To reduce the risk of fire, never leave a space heater on when you go to sleep or place a space heater close to any sleeping person.
- Never leave a space heater unattended; turn it off if you leave the area.
- Never use extension cords to power electric heaters.
- Use only a space heater that has been tested to the latest safety standards and certified by a nationally recognized testing laboratory, and that is equipped with automatic safety switches that turn off if the unit is tipped over accidentally.

RECENT COURT RULINGS

➤ Management Company Can't Own Member's Parking Space

Facts: A condo community has 20 units and 30 parking spaces. At the start of the association, one parking space was assigned to each condominium and 10 spaces were unassigned. A provision in the condominium's declaration permitted the developer to sell the unassigned spaces to members or to third-party non-condominium owners. Under the declaration, no person other than the developer could sell or lease a parking space to a non-condominium owner.

One year, a member purchased a parking space from the developer. The member sold the parking space to the management company. The association acknowledged the management company's use and ownership of the parking space in an annual meeting, and the association provided the management company with a garage door opener after modifying the parking lot to require one.

After the association refused to replace the management company's lost garage opener, the association asked the court to declare that the management company did not own the parking space and that the original transfer of the parking space to the management company violated the association's governing documents. The trial court ruled in favor of the management company under the legal theory of "adverse possession." Adverse possession is the process by which title to another's real property is acquired, without compensation, by holding the property in a manner that conflicts with the true owner's rights for a specified period of time.

The association appealed, and the appeals court reversed the lower court's judgment. The management company then asked the state supreme court to review the decision.

Ruling: The Colorado Supreme Court agreed with the appeals court's decision.

Reasoning: The court ruled that the parking space is a common element of the condominium property that, under the declaration, cannot be sold or leased to a third party who is not a condominium owner. The declaration's intent was to forbid exactly what the management company purports to have happened—a member selling a parking space to a nonmember. The court also stated that as the management company for the condominium, it was aware of the parking space restrictions.

- B.B. & C. Ptnship v. Respondent: Edelweiss Condo. Assn., October 2009

➤ Insurer Not Required to Defend Association Against Member's Lawsuit

Facts: An association obtained insurance liability coverage under two different policies. First, it obtained a commercial general liability policy that provided coverage for property damage. Second, it obtained a directors and officers (D&O) liability policy covering "loss incurred by the association as the result of any claim made against the association for a wrongful act." The policy defined "wrongful act" as any error, misstatement, misleading statement, act, omission, neglect, or breach of duty committed or attempted by the insured organization. The D&O liability policy also expressly excludes coverage for claims against the association for or arising out of any damage, destruction, loss of use, or deterioration of any tangible property.

During the period when both policies were in place, a member sued the association for failure to adequately maintain and repair the roof and air-conditioning system of the condominium building before and after two hurricanes made landfall in the area. The commercial general liability carrier agreed to defend against the lawsuit, but the D&O liability insurer denied the claim. The association hired its own lawyer mistakenly thinking that only the negligence claim was defended and the member's fiduciary duty claim was undefended.

In an amended complaint, the member added allegations of fiscal mismanagement, asserting that the association failed to obtain competitive bids and failed to select a qualified contractor for the restoration of the building. However, the association never forwarded a copy of the amended complaint to the D&O liability insurer. After the lawsuit was resolved, the association sued the D&O insurer and asked the court to declare that the D&O insurer had a duty to defend it and to order the insurer to reimburse the association for fees paid to the attorney.

Ruling: A Florida district court denied the association's request and granted a judgment without a trial in the insurer's favor.

Reasoning: The court ruled that the D&O policy clearly excluded coverage for claims arising out of any damage, destruction, loss of use, or deterioration of any tangible property. The member's complaint alleged mold damage as a result of water infiltration caused by the hurricanes. The court ruled that the claim plainly had its origin in damage to tangible property. As a result, the D&O insurer did not have a duty to defend the association against the claims described in the member's complaint.

- Eastpointe Condo. I Assn. v. Travelers Casualty & Surety Co. of America, October 2009

➤ Court Order Against Harassing Member Didn't Violate Free Speech

Facts: A member repeatedly engaged in outrageous communications and conduct with his association, its managers, and members of its board of directors, which included vulgar and harassing letters, disruption of association meetings, and a physical assault on a board member.

The association sued the member and asked the court to permanently bar the member from using spoken or written words towards any member of the association that harassed or tended to incite a breach of the peace or that verbally harassed or attacked these individuals. The member appealed the trial court's decision, claiming that the injunction violated his right of free speech.

Ruling: A Maryland appeals court agreed with the lower court's decision.

Reasoning: The appeals court ruled that the order did not violate the member's constitutional right to free speech because the order was narrowly tailored to prohibit the member's use of "fighting words" that would tend to incite a breach of the peace or invoke a physical or violent response. The member regularly used personally abusive language against the association and its board members that were likely to provoke a violent reaction. Fighting words are unprotected speech, and the trial court was permitted to ban them without additional justifying circumstances.

- Davidson v. Seneca Crossing Sect. II Homeowner's Assn., August 2009

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